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Supreme Court, U.S.
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No. 85-75

IN THE
SUPREME COURT
OF THE UNITED STATES
October Term, 1985

TENNECO WEST, INC., a Delaware Corporation,
Petitioner,

vs.

MARATHON OIL COMPANY, an Ohio Corporation,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

Respondent is dissatisfied with the petitioner's statement of the questions presented for review and submits that a correct statement is as follows:

1. Did the Ninth Circuit err in relying on California case law to the effect that an oil and gas lease requiring lessee to bear all taxes "upon or referable" to its acts or operations on the leased premises is limited to taxes "upon or referable" to lessee's physical acts associated with producing oil on the premises?

2. Is the windfall profit tax an excise tax imposed on "windfall profit" as that term is defined in the Crude Oil Windfall Profit Tax Act of 1980, 42 U.S.C. § 4986, *et seq.* (Public Law 96-223, 94 Stat. 229, *et seq.*), or is it an excise tax imposed on the physical act of severing oil?

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SUMMARY OF ARGUMENT

Contrary to petitioner's assertions, this is not a case which has far reaching implications, is not a case where the Ninth Circuit erroneously construed the nature of the windfall profit tax, is not a case involving an important question of federal law and is not a case involving an intercircuit conflict. The holding in the Ninth Circuit rests on two very narrow points of law. The first point is one of contract interpretation already established as controlling state law by the courts of California in *Crocker National Bank v. McFarland Energy, Inc.*, 140 Cal.App.3d 6, 189 Cal.Rptr. 302 (1983), *petition for hearing denied*, April 27,

1983 (Appendix D to Petition). The contract (an oil and gas lease) in the case at bar requires the lessee to pay all taxes "upon or referable" to lessee's acts or operations on the leased premises. The question is whether that language requires the lessee to pay only taxes which are on or referable to the physical act of severing oil from the ground or is it very broad in scope requiring the lessee to pay all taxes which would not have come into existence if producing activities had not been carried out and the oil had been allowed to remain in place in the ground? California has adopted the former interpretation and under *Erie Railroad Company v. Tompkins*, 304 U.S. 64 (1938), federal courts are bound by that interpretation.

The second point of law upon which the decision below rests is that the windfall profit tax, whatever else it may be, is clearly not a tax upon or referable to the doing of any physical act. It is, as the statute says and as the Court has declared in *United States v. Ptasynski*, 462 U.S. 74 (1983), an excise tax on "windfall profit" as that term is defined in the Act.

Taken together, these two narrow points of law compel an obvious conclusion. This is a matter of California contract law. There is no substantial federal question. The contract clause in question does not require respondent Marathon to pay petitioner Tenneco's royalty share of the windfall profit tax.

ARGUMENT

I

A Writ of Certiorari Should Not Be Issued Because The Leases In Question Only Require Lessee To Pay Taxes On Or Referable To Physical Acts Of Severing Oil And The Windfall Profit Tax Is Not Such A Tax. The Decision Below Is Therefore Correct.

The decision of the court of appeals was correct and no writ of certiorari should issue. The lease in question only requires lessee to pay taxes which are upon or are referable to the lessee's physical acts of severing oil and gas. Therefore, the lease does not require respondent Marathon, the lessee, to pay petitioner Tenneco's royalty share of the windfall profit tax because whatever dispute there may be as to a proper description of the windfall profit tax, one thing is clear: The windfall profit tax is *not* a tax on or referable to the doing of any physical act. We will discuss this in two steps. First, we will demonstrate that the windfall profit tax is not a tax on the doing of any physical act. Second, we will demonstrate that under controlling California case law, the lease language requiring the lessee to pay all taxes "upon or referable to" its acts or operations on the lease only requires it to pay taxes on or referable to lessee's physical acts associated with producing oil and does not require lessee to pay lessor's windfall profit tax.

The Windfall Profit Tax Act at 26 U.S.C. § 4986 quite clearly describes the tax. It provides as follows:

> (a) Imposition of tax. —*An excise tax is hereby imposed on the windfall profit* from taxable crude

> oil removed from the premises during each taxable period.
>
> (b) Tax paid by producer. — The tax imposed by this section shall be paid by the producer of the crude oil.

(Emphasis supplied.)

Elsewhere, at 26 U.S.C. § 4996(a)(1)(A), the term "producer" is defined to mean "the holder of the economic interest with respect to the crude oil." This includes "royalty owners" as Senate Report (Finance Committee) No. 96-394, November 1, 1979 [to accompany H.R. 3919] declares at page 1:

> The Finance Committee substitute for H.R. 3919, the 'Crude Oil Windfall Profit Tax Act of 1979,' imposes a windfall profit tax on domestic oil producers and *royalty owners* to supplement the decontrol of oil prices announced by the Administration.

Sen. Rep. No. 96-394, 2nd Sess., p. 1, *reprinted in* 1980 U.S. Code Cong. & Ad. News, 413. (Emphasis supplied.) Similar language is found in House Conference Report No. 96-817, March 7, 1980 at 106, *reprinted in* 1980 U.S. Code Cong. & Ad. News, 659.

Other provisions of the Windfall Profit Tax Act show that the windfall profit tax is directly imposed upon "windfall profit" as that term is defined in the Act rather than a tax imposed upon the doing of any physical act of severance. 26 U.S.C. § 4988(a) provides that "the term 'windfall profit' means the excess of the removal price of the barrel of crude oil over the . . . base price of such barrel" as adjusted. Thus, the windfall profit tax is computed on the *price increase* resulting from decontrol. As the Senate Report declares:

> The [Senate] committee believes that the large *price increases* on previously discovered oil resulting from phased decontrol *are an appropriate object of taxation.*

Sen. Rep. No. 96-394, 2nd Sess., p. 6, *reprinted in* 1980 U.S. Code Cong. and Ad. News, 417. (Emphasis supplied.) The House Report similarly declares:

> The committee believes that there should be a tax on the windfall arising from decontrol of crude oil prices and from excessive increases in world oil prices.

H.R. Rep. No. 96-304, 2nd Sess., p. 4, *reprinted in* 1980 U.S. Code Cong. & Ad. News 587, 591.

In *United States v. Ptasynski*, 462 U.S. 74 (1983), this Court characterized the windfall profit tax as follows:

> In 1979, President Carter announced a program to remove price controls from domestic oil by September 30, 1981. See id., at 5. By eliminating price controls, the President sought to encourage exploration for new oil and to increase production of old oil from marginally economic operations. See HR Doc No. 96-107, p 2 (1979). He recognized, however, that deregulating oil prices would produce substantial gains (referred to as 'windfalls') for some producers. The price of oil on the world market had risen markedly, and it was anticipated that deregulating the price of oil already in production would allow domestic producers to receive prices far in excess of their initial estimates. See id., at 2. Accordingly, the President proposed that Congress place an excise tax on the additional revenue resulting from decontrol.

> Congress responded by enacting the Crude Oil Windfall Profit Tax Act of 1980, 94 Stat 229, 26 USC § 4986 et seq. (1976 ed, Supp V). The Act divides domestic crude oil into three tiers and establishes an adjusted base price and a tax rate for each tier. See §§ 4986, 4989, and 4991. The base prices generally reflect the selling price of particular categories of oil under price controls, and the tax rates vary according to the vintages and types of oil included within each tier.

Id. at 76. (Footnotes omitted.)

The very manner in which the tax is calculated shows that the tax is imposed on "windfall profit" rather than the physical act of severing. In *Ptasynski*, this Court described the calculation as follows:

> Generally, the windfall profit is the difference between the current wellhead price of the oil and the adjusted base price. See 26 USC § 4988(a)(1976 ed., Supp. V). The amount of the tax is calculated by multiplying the resulting difference by the applicable rate. § 4987(a). The tax on each barrel of oil thus varies according to the adjusted base price and rate. . . .

Id. at 76 n. 3. Obviously, neither the existence nor amount of the tax is controlled by the physical acts or operations on the leased premises. If the current wellhead price does not exceed the adjusted base price, there will be no windfall profit tax no matter how extensive the physical operations on the leased premises.[1]

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[1]For example, assume a barrel of oil with a wellhead price of $24 and an adjusted base price of $20. The 'windfall profit' would be $4 and assuming a 70 percent windfall profit tax rate, the windfall profit tax

The statute and the legislative history therefore demonstrate that the windfall profit tax is imposed on an economic interest owner's "windfall profit." It is certainly not a tax on the doing of any physical act such as severing oil. Indeed, the obligation to pay the tax is imposed upon persons who hold economic interests, specifically including royalty owners as to their royalty share of the windfall profit, without regard to whether they perform any physical acts at all. Common sense dictates that if Congress had intended the tax to be one levied upon the doing of a physical act, Congress would not have required persons who do not perform physical acts (such as royalty owners) to pay their share of the windfall profit tax.

Having demonstrated that the windfall profit tax is not a tax on the physical act of severance, we now turn to the other half of the equation: The lease language by its terms only requires the lessee to pay taxes upon or referable to its "operations or acts." In other words, the lease language only requires it to pay taxes on or referable to its *physical* acts of severance. Contrary to Tenneco's apparent argument, the lease does not require the lessee to pay all taxes which would not have become due but for the lessee's having conducted operations. As the Ninth Circuit pointed out, that would be absurd. Carried to its logical conclusion, it would mean that a lessee would pay all of the lessor's income tax liability attributable to the lease. Obviously, that was never intended. *Tenneco West, Inc. v. Marathon Oil Co.*, 756 F.2d 769, 773 (9th Cir. 1985)(Petition Appendix B-8).

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would be $2.80 per barrel. Conversely, assuming a wellhead price of $20, the windfall profit would be zero and there would be no windfall profit tax.

In the court below, petitioner Tennec rgued that even if the tax is levied upon windfall profit and not on the physical act of severance, the words "referable to" are still broad enough to cover the lessor's royalty share of the windfall profit tax. The argument has no merit because it misuses the word "referable."

Webster's Third New International Dictionary (Unabridged) defines "referable" as "capable of being considered in relation to something else." "Referable" derives from "refer" which, according to Webster, means "to think of, regard, or classify under a subsuming principle or with a general group." Thus, if things are to be considered under a general principle, i.e., are "referable" to one another, they must share common characteristics. Because the windfall profit tax is "upon" windfall profit and not "upon" the doing of any physical act, the tax can only be "referable" to something which shares common characteristics with "windfall profit." Windfall profit is associated with price or money. It shares no common characteristics with a physical act.[2] Therefore, just as the windfall profit tax is not a tax on the doing of any physical act, so neither is it a tax which is "referable to" the doing of any physical act.

At this point in time, any argument over what the language in question means is purely academic. In California, the court of appeal has ruled on what is meant by the use of the words "upon or referable to." The case is *Crocker National Bank v. McFarland Energy, Inc.*, 140 Cal.App.3d 6, 189 Cal.Rptr. 302 (1983), *petition for hearing denied*, April 27, 1983 (Appendix D to Petition). Because the California Supreme Court denied the petition for

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[2]See fn. 1, supra.

hearing, that decision constitutes controlling state law. *West v. American Telephone & Telegraph Co.*, 311 U.S. 223, 237 (1940).

Crocker decided that a tax clause virtually identical to the tax clause at bar did *not* transfer the royalty owner's windfall profit tax obligation to the operator or lessee.[3] We submit that although perhaps expressed with more brevity than one might now prefer, the reasoning of the *Crocker* case is that the tax clause in question only covers taxes which are upon or referable to the doing of some physical act, such as physically severing oil from the ground. It does not cover all taxes which would not have come into existence but for the conduct of operations. It therefore does not cover taxes on "windfall profit" as that term is defined in the Windfall Profit Tax Act.

The Ninth Circuit Court of Appeals correctly viewed the case at bar as primarily involving a question of lease interpretation and, applying the rule of *Erie Railroad Company v. Tompkins*, 304 U.S. 64 (1938), followed the decision in *Crocker National Bank v. McFarland Energy, Inc.* This was obviously correct. The question of whether this contract language requires a lessee to pay the lessor's

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[3]The tax clause in *Crocker* was virtually identical and provided as follows:

Grantor shall pay ... all taxes, assessments and other governmental charges *upon or referable to any operations or acts of Grantor or on Grantor's behalf of Said Lands*, including (without limiting the generality of the foregoing) the drilling or operation of any well or wells, the production, extraction, severance or removal of any hydrocarbon, the processing, storage or use thereof, the sale of any such hydrocarbon or of any product thereof, or the transportation thereof away from Said Lands. ...

140 Cal.App.3d at 7-8, 189 Cal.Rptr. at 302-03. (Petition Appendix D1-D2)(Emphasis supplied.)

royalty share of the windfall profit tax should not vary according to whether the lessor files his case in the California state courts or in the federal district court under diversity jurisdiction.

The Ninth Circuit Court of Appeals reasoned, in the alternative, that even if it were to accept Tenneco's argument that the characterization of the tax presents a threshold federal question, nevertheless the tax very clearly is an excise tax on "windfall profit." In so doing, the court relied in part on this Court's decision in *United States v. Ptasynski*, 462 U.S. 74 (1983).

In arguing that the court of appeals erred, petitioner Tenneco contends that the Ninth Circuit construed the windfall profit tax as being a tax on income or profits, apparently in a federal income tax sense, as distinguished from an excise or severance tax. (Petition at p. 15, et seq.) In so doing, petitioner makes two mistakes.

Petitioner's first mistake is that it mischaracterizes the Ninth Circuit decision. That court never said that the windfall profit tax was a tax on income or profits in an income tax sense. Instead, the Ninth Circuit very accurately described the tax as follows:

> The Act imposes an 'excise tax . . . on the windfall profit from taxable crude oil removed from the premise. . . .' 26 U.S.C. § 4986(a). The tax is imposed on the producer of oil, defined as the 'holder of the economic interest with respect to the crude oil.' 26 U.S.C. § 4996(a)(1)(A). This includes royalty owners such as Tenneco. *See* S.Rep. No. 394, 96th Cong., 2d Sess. 1, *reprinted in* 1980 U.S.Code Cong. & Ad. News 410, 413. Windfall profit is defined as 'the excess of the

> removal price of the barrel of crude oil over the . . . base price of such barrel. 26 U.S.C. § 4988(a).

756 F.2d at 772. (Petition Appendix B-5.) The court below therefore very clearly understood that the windfall profit tax is just what the Act says it is: An *excise* tax on "*windfall profit*" as that term of art is defined in the Act.

Petitioner Tenneco's second mistake is to rely on various statements of legislators contained in the legislative history to the effect that the tax is a "severance tax." This is nothing more than arguing by labels.[4] Petitioner assumes that "severance taxes" are necessarily taxes upon the physical act of producing and cannot be excise taxes on windfall profit as that term is defined in the Act. Petitioner is wrong. The term "severance tax" can be, and has been, used to describe a broad variety of taxes:

> A number of oil and gas producing states have enacted statutes levying taxes based on the value of the gross production of oil and gas during stated periods. These taxes are called production, severance, occupation, privilege and distribution taxes. Some of them are held to be occupation or privilege taxes and others are held to be property taxes.

4 W. Summers, *The Law of Oil and Gas*, § 801, 409 (Perm. Ed. 1954). In short, a severance tax is not necessarily imposed on the physical act of severing. There is therefore no magic in the fact that the windfall profit tax has sometimes been called a "severance" tax. That does not convert it to that which it is not — a tax on the doing of a

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[4]The nature of a tax is determined by its operation and not by mere labels. Educational Film Corp. v. Ward, 282 U.S. 379, 387 (1931).

physical act or, indeed, anything other than an excise tax on "windfall profit" as that term is defined in the Act.

All of the foregoing makes it clear that the Ninth Circuit Court of Appeals was correct. For that reason, the writ of certiorari should not issue.

II

A Writ Of Certiorari Should Not Be Issued Because The Decision Of The Ninth Circuit Court Of Appeals Does Not Involve An Important Question Of Federal Law Which Has Not Been But Should Be Settled By This Court And Is Not A Decision In Conflict With The Decision Of Another Federal Court Of Appeals On The Same Matter.

Petitioner seeks to present the Ninth Circuit decision in the case at bar as involving an important question of federal law which has not been but should be settled by this Court and as one involving a potential conflict between circuits. Neither of these two characterizations is at all accurate and the case is simply not the sort of case that should be taken by this Court.

First, as already pointed out in the preceding section of this brief, the Supreme Court has spoken on the character of the Crude Oil Windfall Profit Tax Act in *United States v. Ptasynski*, 462 U.S. 74 (1983). The decision of the Ninth Circuit in the case at bar is perfectly consistent with this Court's characterization of the Crude Oil Windfall Profit Tax Act in *Ptasynski*. There is therefore no important unanswered question of law here involved.

Second, there is no conflict between circuits. All but one of the cases to which petitioner points as creating a potential conflict are cases arising in the United States District Court for the Central District of California (Petition at 10-12). As petitioner notes, these cases are on appeal to the Ninth Circuit. It seems unlikely to respondent Marathon that any of those cases will be affected by the case at bar because none of those cases involve the same lease language as is involved here and because none seem to depend in any way on whether the windfall profit tax is a tax on the doing of any physical act. Even if these cases were to depend in some way on the outcome of the case at bar, they certainly present no potential for intercircuit conflict because they will be decided by the same court that decided this case and presumably will be decided in a way that does not create conflict. At most, there could be an int*ra*circuit conflict. In that event, there is still no compelling reason for the Supreme Court to issue a writ of certiorari. *See, Davis v. United States*, 417 U.S. 333, 340 (1974). (Solicitor General argued that certiorari should not be granted where the conflict was intracircuit. The petition for writ of certiorari was denied.) The Ninth Circuit can resolve an intracircuit conflict itself in an in banc proceeding. 28 U.S.C. § 46(c); Fed. R. App. P. 35.

The other case cited by petitioner in support of its claim of a "potential" conflict is *New Mexico v. Regan*, 745 F.2d 1318 (10th Cir. 1984) (transferred to Ct. Cl.) (A copy of this case is reproduced as Appendix G to the Petition.) (Petition at 10, 12-15.) Petitioner admits that that case involves different issues than those present in this case. (Petition at 10.) Indeed, the main thrust of *New Mexico v. Regan* concerns the district court's lack of jurisdiction over money claims in excess of $10,000 against the United States. *Id.* at 1320-22. (Petition Appendix at G6-G10.)

Although the dispute in that case concerns the windfall profit tax, the case at bar would not seem to have any effect on the outcome because that case does not seem to depend in any way on either the lease language in the case at bar or a determination that the windfall profit tax is not a tax on the physical act of severing. Further, the case at bar does not even touch upon the Mineral Lands Leasing Act of 1920 which is of prime importance to the *New Mexico* case. Even if the *New Mexico* case were ultimately found to turn on some point involved with the case at bar, that still would not demonstrate any likelihood of, or even a potential for, a conflict between circuits. There is nothing to indicate that the *New Mexico* case is likely to be decided in a way which will be inconsistent with the case at bar.

As petitioner recognizes, this case is the only opinion of a federal court of appeals on the issues in question here. (Petition at 14.) Now federal and state courts will have a decision to which to look for guidance.[5] Therefore, rather than create inevitable conflict, the presence of this case actually promotes uniformity.

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[5]Petitioner also states (Petition at 14) that Humble Exploration Co. v. Amcap Petroleum Associates — 1977, 658 S.W.2d 860, 861 (Tex. Civ. App. 1983) is in conflict with the Ninth Circuit decision in the case at bar. This is not so. There, the Texas court specifically declined to decide whether the windfall profit tax could properly be denominated as a "severance" or "production" tax. The court declared that in the overall context of the contract there involved, this decision was not necessary. Even if one were to assume, for sake of argument, that the case at bar, which applies California law, and the *Humble* case were in conflict, it would be irrelevant. A conflict over a question controlled by state law is not a ground for granting certiorari because such a conflict may be corollary to a permissible difference of opinion between state courts. Ruhlin v. New York Life Insurance Co., 304 U.S. 202, 206 (1938).

CONCLUSION

The decision of the court of appeals in the case at bar which followed controlling California law in *Crocker National Bank v. McFarland Energy, Inc.*, 140 Cal.App.3d 6, 189 Cal.Rptr. 302 (1983), *petition for hearing denied*, April 27, 1983, is correct. Furthermore, contrary to petitioner's exhortations, the decision in the Ninth Circuit Court of Appeals does not involve an unanswered question of federal law which should be settled by this Court and is not a decision in conflict with the decision of any other federal court of appeals. A writ of certiorari should therefore not be issued and the petition for writ of certiorari should be denied.

Respectfully submitted,

EDWARD S. RENWICK
BELA G. LUGOSI
HANNA AND MORTON

J. CRAIG JENKINS
CLIFFORD, JENKINS & BROWN

STATEMENT REQUIRED UNDER RULE 28.1 OF THE RULES OF THE SUPREME COURT

Following is a list of all parent companies, subsidiaries (except wholly owned subsidiaries) and affiliates of respondent Marathon Oil Company:

United States Steel Corporation

Artic LNG Transportation Company

Kenai LNG Corporation

Oil Insurance Limited

Polar LNG Shipping Corporation

PROOF OF SERVICE BY MAIL

I am a citizen of the United States and a resident of the City and County of Los Angeles; I am over the age of eighteen years and not a party to the within action; my business address is: 3550 Wilshire Boulevard, Suite 916, Los Angeles, California. On this date, August 30, 1985, I served the within BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI in re: "Tenneco West, Inc. vs. Marathon Oil Company" in the Supreme Court of the United States, October Term, 1985, No. 85-75;

on the persons interested in said action by placing 3 true copies thereof enclosed in sealed envelopes with first class postage prepaid, in the United States post office mail box at Los Angeles, California, addressed as follows:

KEITH K. HILBIG
SMITH & HILBIG
Suite 1290
21515 Hawthorne Blvd.
Torrance, CA 90503

All parties required to be served have been served.

I certify (or declare) under penalty of perjury that the foregoing is true and correct.

Executed on August 30, 1985

at Los Angeles, California.

Kathleen Kettenbach